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Legend

Taypayer =

Trust =

Plan =

Dear :

This is in reply to your letter dated July 30, 2009 and subsequent correspondence in which you request various rulings on behalf of Taxpayer with respect to Trust and Plan.

FACTS

Taxpayer is an unincorporated entity that is funded with payments from the state pursuant to statute. School districts from a specific region of the state are assigned to entities such as Taxpayer. Taxpayer provides services for member school districts that were previously provided by district school boards, such as vocational, guidance,

counseling, visual, speech and hearing services. Taxpayer has a board of directors made up of representatives from the member school districts.

Taxpayer established Plan and adopted Trust to provide health benefits to its eligible retirees. Taxpayer is the sole employer participating in Plan. Taxpayer is authorized to amend or terminate Plan.

Plan provides all benefits through insurance contracts. Eligibility under Plan is based on years of service with Taxpayer upon retirement, attaining a certain age for certain classes of employees, and Medicare eligibility. Plan includes provisions concerning the termination of benefits. Benefits under Plan are offered only to retired employees of Taxpayer. The Taxpayer's liability for the cost of benefits for retirees equals the total premium charge to cover an eligible employee at retirement, minus the employee's required monthly contribution at retirement. Any increases in cost of health insurance after the date of retirement are the responsibility of the eligible retiree.

Taxpayer represents that there are no pre-tax salary reduction elections under Plan. In addition, Taxpayer represents that Plan does not permit a cash-out of unused amounts or conversion of sick or vacation days to retiree health benefits. Taxpayer does not provide benefits to individuals who do not qualify as a retiree.

Taxpayer created Trust as a vehicle for funding retiree health benefits under Plan. Currently, Trust assets consist of contributions made by Taxpayer and investment income. Trust assets are to be used exclusively for benefits under Plan and for all reasonable and necessary expenses of administering Trust. The income of Trust accrues to Taxpayer. Private interests do not participate in Trust. No part of Trust may be diverted to purposes other than the exclusive benefit of the participants.

Taxpayer will have exclusive authority and discretion to manage and control the assets of Trust, but will delegate investment management of Trust's assets to the trustee pursuant to the terms of the Trust Agreement. Under the terms of the Trust Agreement, Taxpayer may remove and replace the trustee of the Trust at any time, upon 60 days prior written notice. In the event of the trustee's removal or resignation, a successor trustee will be appointed by Taxpayer.

Taxpayer represents that the purpose of the Trust is to vest in the trustee responsibility for the protection and conservation of Trust property for the benefit of the Plan participants, none of whom can share in the discharge of this responsibility for profit.

Trust provides that Taxpayer may amend Trust at any time. Taxpayer may terminate Trust only upon the payment of all Trust obligations and expenses. Any remaining Trust assets may be distributed in accordance with the direction of Taxpayer. The Trust provides that in no case will assets be distributed to an entity that is not a state, a

political subdivision of a state, or an entity the income of which is excluded from gross income under § 115 of the Internal Revenue Code (the Code).

LAW AND ANALYSIS

Section 115(1) of the Code provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

In Rev. Rul. 77-261, 1977-2 C.B. 45, income from an investment fund, established under a written declaration of trust by a state, for the temporary investment of cash balances of the state and its participating political subdivisions, was excludable from gross income for federal income tax purposes under § 115(1). The ruling indicated that the statutory exclusion was intended to extend not to the income of a state or municipality resulting from its own participation in activities, but rather to the income of a corporation or other entity engaged in the operation of public utilities or the performance of some governmental function that accrued to either a state or municipality. The ruling points out that it may be assumed that Congress did not desire in any way to restrict a state's participation in enterprises that might be useful in carrying out projects that are desirable from the standpoint of a state government and which are within the ambit of a sovereign to properly conduct. In addition, pursuant to § 6012(a)(2) and the underlying regulations, the investment fund, being classified as a corporation that is subject to taxation under subtitle A of the Code, was required to file a federal income tax return each year.

In Rev. Rul. 90-74, 1990-2 C.B. 34, the Service determined that the income of an organization formed, funded, and operated by political subdivisions to pool various risks (casualty, public liability, workers' compensation, and employees' health) is excludable from gross income under § 115 of the Code. In Rev. Rul. 90-74, private interests neither materially participate in the organization nor benefit more than incidentally from the organization.

Trust provides health benefits to retired employees of Taxpayer, an entity of the state. Taxpayer receives funding from state as well as from member school districts and helps state accomplish its governmental purpose of providing education to its residents. Providing health benefits to current and former employees constitutes the performance of an essential government function. Based upon Rev. Rul. 90-74 and Rev. Rul. 77-261, Trust performs an essential governmental function within the meaning of § 115(1) of the Code.

The income of Trust accrues to Taxpayer. Taxpayer is the sole participating employer in Plan. No private interests participate in or benefit from the operation of Trust. Any distribution of remaining funds in Trust to participating retirees upon the dissolution of Trust satisfies an obligation the Taxpayer has assumed with respect to providing health

benefits to its retirees. The benefit to the participating retirees is incidental to the public benefit. See Rev. Rul. 90-74.

Section 6012(a)(4) of the Code provides, in general, that every trust having for a taxable year any taxable income, or having gross income of \$600 or more, regardless of the amount of taxable income, shall make returns with respect to income taxes under subtitle A. However, no annual return is required to be filed by Trust if income realized by Trust is excluded from gross income under § 115(1)

Section 7701(a) and § 301.7701-4 of the Procedure and Administration Regulations define trusts for purposes of § 6012. Section 301.7701-4(a) provides, in general, that an arrangement will be treated as a trust under the Code if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

In this case, the Taxpayer contributes money to the Trust to provide health benefits for former employees. The trustee of Trust is given responsibility to protect and conserve the Trust's assets for the beneficiaries who cannot share in the discharge of this responsibility and, therefore, is not an associate in a joint business for profit.

Section 61(a)(1) of the Code and § 1.61-21(a)(3) of the Income Tax Regulations provide that, except as otherwise provided in subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 106(a) of the Code provides that gross income of an employee does not include employer-provided coverage under an accident or health plan.

Section 1.106-1(a) of the regulations provides that gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries for sickness incurred by him, his spouse, or his dependents, as defined in § 152. The employer may contribute to an accident or health plan either by paying the premium (or a portion of the premium) on a policy of accident or health insurance covering one or more of his employees, or by contributing to a separate trust or fund (including a fund referred to in § 105(e)) which provides accident and health benefits directly or through insurance to one or more of his employees. However, if the insurance policy, trust or fund provides other benefits in addition to accident or health, § 106 applies only to the portion of the contributions allocable to accident or health benefits.

Coverage provided under an accident and health plan to former employees and their spouses and dependents is excludable from gross income under § 106. See Rev. Rul. 62-199, 1962-2 C.B. 32; Rev. Rul. 82-196, 1982-2 C.B. 53.

Section 105(a) provides that, except as otherwise provided in § 105, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(b) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in § 213)) of the taxpayer, his spouse, and his dependents (as defined in § 152 of the Code).

Based on the information submitted and representations made, we conclude as follows:

- (1) Trust income is derived from the exercise of an essential governmental function and will accrue to a state or political subdivision thereof for purposes of § 115(1). Accordingly, Trust's income will be excludable from gross income under § 115(1) of the Code.
- (2) Trust is classified as a trust for federal income tax purposes within the meaning of Section 7701(a) of the Code and § 301.7701-4 of the regulations. Because Trust is classified as a trust, and because Trust's income is excludable from gross income under § 115(1) of the Code, Trust will not be required to file an annual income tax return under § 6012(a)(4) of the Code.
- (3) Contributions paid to Plan and payments made from Plan which are used exclusively to pay for the accident or health coverage of retired employees are excludable from the gross income of retired employees under §§ 106 and 105(b) of the Code.

No opinion is expressed concerning the federal tax consequences of Plan or Trust under any other provision of the Code other than those specifically stated herein.

This ruling is directed only to the Taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely,

Harry Beker, Chief
Health & Welfare Branch
Office of Division Counsel/Associate Chief
Counsel
(Tax Exempt and Government Entities)